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Pizza Hut, Inc.
1975 Annual Report

Annual Meeting

The Annual Meeting of Shareholders will be held at 9:00 a.m., Monday, August 11, 1975, at the Corporate Offices, Wichita, Kansas. A formal notice of the meeting, together with proxy material, is being sent separately to shareholders.

Corporate Data

Common Stock
Stock symbol: PIZ — Traded NYSE
Transfer Agents: First National City Bank, New York, and First National Bank in Wichita.

Registrars: First National City Bank, New York, and The Fourth National Bank & Trust Co., Wichita.

10-K Report Available

A copy of Pizza Hut, Inc.'s 10-K Report filed with the Securities and Exchange Commission for 1975 can be obtained without charge by writing to:

A. Tracy Burton
Director of Investor Relations
Pizza Hut, Inc.
P.O. Box 428
Wichita, Kansas 67201

Corporate Offices

10225 E. Kellogg
Wichita, Kansas 67207
Tel. (316) 687-4111

Auditors

Ernst & Ernst
Wichita, Kansas

Our Business

Pizza Hut, Inc. is presently engaged in the operation, development, franchising and servicing of a system of family restaurants under the name "Pizza Hut." Pizza Hut, Inc. intends to continue its leadership in the pizza market and to develop into a more significant factor in the food service industry.

See return mail card
at the end
of the Financial Section
if you wish
to be placed on our
special mailing list.



Quarterly Review

	Sales	1975 Net Income	Earnings Per Share	Sales	1974* Net Income	Earnings Per Share
First Quarter						
Ended June 30	\$ 37,088,357	\$ 2,434,888	.53	\$ 25,798,688	\$1,678,170	.37
Second Quarter						
Ended Sept. 30	\$ 42,743,932	\$ 2,737,163	.60	\$ 30,217,716	\$1,997,403	.43
Third Quarter						
Ended Dec. 31	\$ 44,222,841	\$ 2,616,823	.58	\$ 31,213,013	\$1,869,558	.42
Fourth Quarter						
Ended March 31	\$ 43,460,446	\$ 2,234,991	.49	\$ 31,804,207	\$1,690,394	.37
TOTAL	\$167,515,576	\$10,023,865	2.18	\$119,033,624	\$7,235,525	1.59

History of growth, five year review

	Fiscal Years ended March 31				
(Dollars in thousands)	1975	1974*	1973*	1972*	1971*
Net Sales.....	\$167,516	\$119,033	\$79,821	\$56,768	\$38,301
Franchise Fees					
Initial.....	\$ 747	\$ 844	\$ 589	\$ 336	\$ 317
Continuing.....	\$ 3,709	\$ 2,280	\$ 1,341	\$ 830	\$ 739
Total Revenues.....	\$171,972	\$122,157	\$81,751	\$57,934	\$39,357
Net Income.....	\$ 10,024	\$ 7,236	\$ 4,813	\$ 2,797	\$ 1,479
Percentage to Net Sales.....	6.0	6.1	6.0	4.9	3.9
Earnings Per Share**.....	\$ 2.18	\$ 1.59	\$ 1.10	\$.72	\$.42
Working Capital.....	\$ 11,029	\$ 8,544	\$ 6,068	\$ 1,044	\$(1,015)
Current Ratio.....	1.75	1.68	1.63	1.15	.83
Stockholders' Equity.....	\$ 46,122	\$ 35,688	\$28,217	\$13,976	\$10,253
Percentage Return on Stockholders' Equity.....	28.1	25.6	34.4	27.3	17.2
Total Assets.....	\$ 85,189	\$ 65,220	\$46,749	\$28,999	\$20,244
Number of Restaurants					
Company Owned.....	997	623	490	359	259
Franchise System.....	878	864	640	496	409
Total.....	1,875	1,487	1,130	855	668

* Restated

** Fully diluted — assuming exercise of options, warrants,
and conversion of convertible notes

To Our Shareholders



Pizza Hut, Inc. has successfully completed the most challenging year of our six and a half years as a publicly-held company.

Our strategy entering the year was to concentrate our resources on our domestic Pizza Operations (both Franchise and Company). Our objectives were to increase the sales and profitability of existing units while increasing market penetration through a balanced program of adding new units. We also planned to increase the support of our domestic Pizza Operations by expanding our supply and distribution subsidiary, Franchise Services, Inc. (FSI), and to continue the development and controlled growth of our foreign operations.

As the planned strategy began to unfold, the opportunity to merge with Pizza Corporation of America (PCA), our largest franchisee, was presented to us. The preliminary agreement was signed May 23, 1974 and the merger was approved by the shareholders on September 26, 1974. From our base of 660 Company units we began immediately to integrate the 225 PCA units into our management system . . . an integration that would see us increase our number of units by 34 per cent. The two companies, while similar in unit operation, had many differences in procedure; area management supervision, real estate and administration. The management groups of both organizations, working closely on an accelerated plan, completed the integration by March 1, 1975.

Substantial costs associated with the merger were incurred and have been expensed in our fiscal '75 statements. The two systems are now aligned as we move into the new year.

While dealing with the complexities of the merger, our management was further tested in attempting to meet the aggressive new unit development and sales goals in a depressed economic environment the likes of which this management group had not seen.

Our publicly stated development goal was 185 additional units (including PCA) and 150 additional franchise units. The Company opened 187 units while the franchisees opened 201. Our average unit sales, in spite of the depressed economy, increased approximately 13 per cent. Price increases, the implementation

of our pasta program, and additional national and local advertising were primarily responsible for the increase. However, the economy's impact was felt dramatically in the months of September and December of 1974 and January and February of 1975 when our real sales growth in the units was minimal to slightly negative. We were slow in exercising our capability to respond to this sales softness. In March, 1975 we experienced our worst month in over four years with a negative 3.4 per cent real sales growth. There was no doubt at that time we had to become more aggressive in the marketplace.

FSI opened its fifth distribution center in Indianapolis, Indiana in September, 1974 and now services approximately 74 per cent of the system's units. An additional 25 per cent of the units are serviced by associated distributors.

The growth and profitability of our foreign operations proceeded on plan with the exception of our German and Canadian operations. For the fiscal year ended March 31, 1975 West Germany operations resulted in a loss of \$569,000 and Canadian operations resulted in a loss of \$352,000. Since March 31, 1975 the Company has closed three and has franchised two of the five Pizza Hut restaurants in West Germany. Management changes in Canada, combined with some success in obtaining beer licenses in eastern Canada, have significantly changed the direction of these operations. As of March 31, 1975 the Company had under construction one Pizza Hut restaurant in England and one in Australia and the franchisees had three Pizza Hut restaurants under construction in Canada and one each in Australia, Guatemala, Guam, Virgin Islands and the Netherlands.

A Look Into Fiscal Year '76

Fiscal '76 is difficult to predict. Our consumers' disposable incomes have decreased. Our plan remains centered around the increased productivity of individual units and the addition of new units. To accomplish this in today's economy requires a different set of actions than in the past four years. A higher degree of aggressiveness in terms of promotion, combined with increased advertising expenditures, will be necessary to achieve our sales goals.

To assure our growth in number of units and to attain the balance sheet strength necessary to compete in future capital markets, a subordinated convertible debenture offering has been filed with the Securities and Exchange Commission. This additional twenty-five million dollars in capital is to be used exclusively to increase our percentage of ownership of real estate (Pizza Hut restaurant buildings and land).

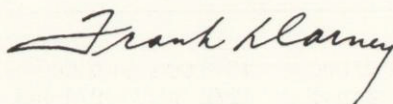
Our franchisees continue to advance in strength and professionalism. They recently streamlined their association, The International Pizza Hut Franchise Holders Association (the national advertising arm of the system), to more efficiently carry out the stated purposes of advertising, while at the same time enabling it to better meet other needs of its members and serve as a spokesman for the franchisees to the Company. Elected I.P.H.F.H.A. Board members give freely of their time and talent for the betterment of the system.

The Pizza Hut name and product have received significant recognition in the past year as the Pizza Hut Basketball Classic (our annual post season charitable event) continues to move our system and its people toward positive community involvement. Agreements have been completed which will see two Pizza Hut toys for children marketed by others. Additionally, numerous articles have been written demonstrating the nutritional benefits of pizza in comparison with other popular foods. These are important as pizza was long considered a fad food. As one magazine recently put it — "Pizza, the longest fad on record, is an American institution, second only to hamburger in national popularity."

No single report can convey what a company or system is, but I urge you to study this report. Every year changes are made in the format so that you, our stockholders, can more fully understand your Company. Our three key success factors are . . . to build Pizza Hut restaurants . . . to supply Pizza Hut restaurants and . . . to operate Pizza Hut restaurants . . . profitably. Our management, with strong staff support, has been organized around these factors, which will be further explained in the pages that follow. I hope I have conveyed to you that we are larger, more profitable, and financially stronger than we have ever been. We have made mistakes . . . some of them costly . . . but we continue to learn and grow from them.

We had a good year in an environment of economic uncertainty. Our momentum is positive and our management continues to build on its strengths for the overall growth, profitability, and value of the Company.

Respectfully,



Frank L. Carney, President
Chairman of the Board
& Chief Executive Officer

Revenues and Contribution to Income Pizza Hut, Inc. and Subsidiaries

Fiscal Years Ended March 31

(Dollars in Thousands)

Pizza Hut, Inc. is principally engaged in the operation, development, franchising and servicing of a system of family restaurants under the name "Pizza Hut." Pizza Hut restaurants sell pizza, pasta products, sandwiches and a limited menu of complementary food products at moderate prices prepared under recipes and procedures prescribed by the Company. The Company also manufactures certain fixtures and supplies, processes a variety of spice blends used in its pizza and pasta products, and distributes equipment, supplies and food products for use in its restaurants and sale to franchisees. In addition, the Company operates 15 Mexican food restaurants under the name "Fiesta Cantina."

The following table sets forth for each of the Company's activities the

respective amounts and percentages of revenues and of contribution to consolidated income before general and administrative expenses attributable to the home office and income taxes. The Company believes that allocating such expenses and taxes would be arbitrary due to the close relationship and interdependency of all of its activities. Expenses (other than general and administrative expenses attributable to the home office and income taxes) related to "franchise fees" have been allocated to Company Pizza Hut restaurants. The table includes for all periods the sales by businesses acquired by the Company from March 31, 1970, through March 31, 1975, in transactions accounted for as poolings of interests and eliminates intercompany transactions.

	1975		1974*		1973*		1972*		1971*	
Revenues:										
Company Pizza Hut restaurants	\$137,117	79.7%	\$ 99,116	81.0%	\$68,483	83.8%	\$48,313	83.4%	\$32,295	82.1%
Sales to franchisees	28,315	16.5	16,810	13.8	7,127	8.7	4,288	7.4	2,715	6.9
Other restaurants	2,084	1.2	3,041	2.5	3,930	4.8	3,795	6.6	2,879	7.3
Frozen pizza crusts			66	.1	281	.3	372	.6	412	1.0
Franchise fees:										
Initial	747	.4	844	.7	589	.7	336	.6	317	.8
Continuing	3,709	2.2	2,280	1.9	1,341	1.7	830	1.4	739	1.9
	\$171,972	100.0%	\$122,157	100.0%	\$81,751	100.0%	\$57,934	100.0%	\$39,357	100.0%
Contribution to income:										
Company Pizza Hut restaurants (1)	\$ 23,644	85.1%	\$ 17,743	89.5%	\$11,999	91.0%	\$ 8,102	98.5%	\$ 4,314	96.0%
Sales to franchisees	678	2.4	362	1.8	274	2.1	168	2.0	41	.9
Other restaurants	(47)	(.2)	157	.8	(120)	(.9)	(76)	(.9)	(700)	(15.6)
Frozen pizza crusts			(17)	(.1)	(261)	(2.0)	(72)	(.9)	16	.4
Excess Properties (2)	(948)	(3.4)	(1,551)	(7.8)	(635)	(4.9)	(1,062)	(12.9)	(231)	(5.1)
Franchise fees:										
Initial	747	2.7	844	4.3	589	4.5	336	4.1	317	7.0
Continuing	3,709	13.4	2,280	11.5	1,341	10.2	830	10.1	739	16.4
	\$ 27,783	100.0%	\$ 19,818	100.0%	\$13,187	100.0%	\$ 8,226	100.0%	\$ 4,496	100.0%
General and administrative expenses attributable to the home office	8,363		5,527		3,933		2,938		1,977	
Income before income taxes	\$ 19,420		\$14,291		\$ 9,254		\$ 5,288		\$ 2,519	

* Restated

(1) Before deducting continuing losses of carrying closed Pizza Hut restaurants amounting to approximately \$5,000, \$30,000, \$130,000, \$313,000 and \$227,000 in the fiscal years 1971 through 1975, respectively, and write-offs of tangible and intangible assets pertaining to such restaurants amounting to approximately \$47,000 in fiscal year 1972, \$187,000 in fiscal year 1974 and \$58,000 in fiscal year 1975. Such losses and write-offs are included in "Excess Properties."

(2) Excess properties consist of properties initially owned or leased for restaurant or related purposes but which are now held for disposition, and include closed Taco Kid, Next Door and Pizza Hut restaurants. The

losses from "excess properties" include approximately \$150,000, \$613,000, \$122,000, \$938,000 and \$400,000 in fiscal years 1971, 1972, 1973, 1974 and 1975, respectively, representing write-offs of tangible and intangible assets pertaining to closed Taco Kid, Next Door and Pizza Hut restaurants. The balance of such losses consists of expenses incurred in carrying such properties less any income derived from the leasing or disposition of such properties. The Company no longer operates any Next Door restaurants and has converted all except one of its Taco Kid restaurants into Mexican food restaurants operating under the name Fiesta Cantina.

Build Pizza Hut Restaurants

The building of new restaurants continues into fiscal '76 at a pace established in the previous two years, of averaging a "new unit opening per day" franchise and company combined.

The Company's expansion is targeted for 200 new units in the coming year. Preparation for this aggressive development plan must begin months in advance of the fiscal year. Under the direction of the Management Committee, our real estate staff, in coordination with our operations management, selects the market areas to receive additional units. The plan balances new areas with mature markets to reach the overall market blend desired.

New Pizza Hut restaurants provide additional parking facilities, a larger dining area, and more kitchen and storage space to accommodate increased sales volumes of the future. As illustrated on our report cover, the signage and exterior of our unique building have been redesigned to accommodate our new graphic logo type and exterior colors, enhancing our image as a family restaurant.

The Property Management division of Pizza Hut, Inc. is responsible for site selections, construction, installation of equipment and remodeling of Company restaurants. District directors of real estate located in regional offices throughout the country have the responsibility for site selection and have established rigid criteria for our new restaurant locations. Each approved site becomes the responsibility of one of the Company's field construction engineers who obtains the necessary permits and oversees the construction.

This year a Facilities department was created to coordinate construction and equipment installation. In addition, this department has the responsibility for building design and layout, equipment research, and the remodeling of existing units in keeping with our "perpetual newness" concept.



"Our publicly stated development goal was 185 additional units (including PCA) and 150 additional franchise units. The Company opened 187 units while the franchisees opened 201."

Supply Pizza Hut Restaurants

The Company conducts a complete supply and distribution service for owned and franchisee operated restaurants through its wholly-owned subsidiary, Franchise Services, Inc. (FSI). The products purchased, warehoused, and offered for sale to franchisees, together with products manufactured by the Company, constitute a substantially complete line of equipment, fixtures, food products and supplies needed in the operation of Pizza Hut restaurants. Products manufactured at the Wichita facility include table tops, booths, candles and candleholders, table cloths and aprons. In addition, the Company operates its own spice blending operation for use in preparation of all pizza and pasta products.

A centrally located equipment distribution center is in Wichita, Kansas and provides a one-stop center for nearly all of the equipment and fixtures used in Pizza Hut restaurants. This provides the convenience of coordinated delivery in a single trailer, thereby helping to accelerate opening day.

Distribution centers for food products are located in Arlington, Texas; Orlando, Florida; Morrow, Georgia; Indianapolis, Indiana; and Peoria, Illinois. A west coast location is targeted for September, 1975, and a northeastern location is in the planning stages. In addition, FSI has approved four outside distributors beyond our geographic distribution capabilities to handle some of our products.

Except for our special blends of spices, which must be purchased from FSI, franchisees are not required to purchase from the Company. The Company enjoys a high degree of loyalty from its franchisee customers and has agreed to limit pre-tax profit that it derives from the sales of FSI to 2.5 per cent.

Few chain restaurant companies operate a full-line distribution system. Our Company has reviewed the use of outside sources to supply our needs and has concluded that we can fulfill this service more economically from within, exercising a high degree of control over product quality and availability. We are committed to providing supply and distribution services to the Pizza Hut system and consider it a strength in attaining our long range goals.



"FSI opened its fifth distribution center in Indianapolis, Indiana in September, 1974 and now services approximately 74% of the system's units. An additional 25% of the units are served by associated distributors."

Operate Pizza Hut Restaurants . . . Profitably

"Our People Make It Better" was the new advertising theme for the past year. Throughout fiscal 1975 our people responded to meet our goals. The merger with our largest franchisee, Pizza Corporation of America, added 225 additional units and over 2,000 employees to the operations division. The numerous physical changes that the merger created placed an extra strain on many of our people. New area offices were established, training increased and the control functions from our accounting department were strengthened.

In the planning phase of the merger's implementation, the strength of our District Manager concept became apparent. The promotion of 30 field operations personnel to District Managers has allowed us to maintain our span of control commensurate with the growth of the operations division. It allowed us to concentrate on training at the field level for our Area General Managers, the persons primarily responsible for the success of the individual unit. In addition, the District Manager concept will increase the effectiveness of decentralized decision making, so critical in today's rapidly changing business environment.

In fiscal year 1975, we modified the manager bonus program to allow the unit manager to receive additional compensation for achieving stated goals. The bonus program, based upon individual unit performance, enhances our decentralized decision making concepts.

This year, successful entry into several metropolitan markets was especially rewarding. We moved into the Eastern markets of Detroit, Cleveland, Philadelphia and Long Island, receiving excellent consumer response. Additional units are planned for the coming fiscal year and we look forward to serving the Northeastern part of the country.

One of our main concerns, energy cost and availability, remains with us in the future. We have experienced increases in our utility costs and believe that increasing costs will remain a part of doing business. We have implemented an energy plan at the unit level, insuring effective energy conservation as we continue to research our energy options.



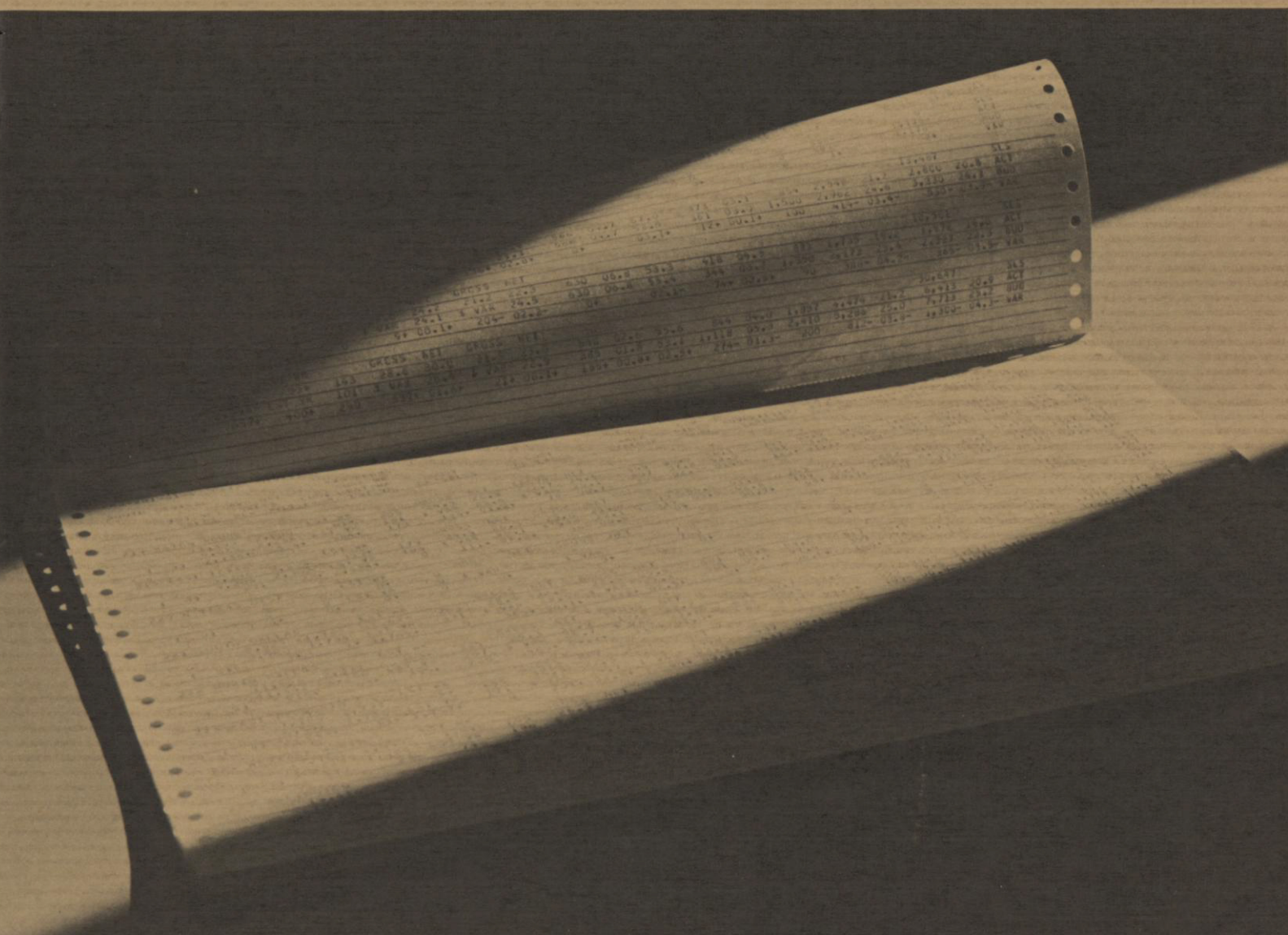
"We began immediately from our base of 660 Company units to integrate the 225 PCA units into our management system . . . an integration that would see us increase our units by 34%."

Operate Pizza Hut Restaurants . . . Profitably (continued)

A meaningful factor in our results for the past fiscal year has been the increase of our average unit sales volume. Complete implementation of our "oven baked" pasta program contributed significantly to our unit sales increases. Pasta accounts for approximately six per cent of total sales and, more importantly, is an additional product choice to our consumer. We will continue to emphasize our pasta program with television commercials planned during peak pasta usage periods.

New products have been significant to the success of most major restaurant chains. We continue to research the desires of our consumers for additional products and programs. We are currently in a limited test phase with a second pizza product. The development of the product is directly associated with consumer desires. Initial testing in select markets has been favorable. Our past success with new product development, testing and implementation serves as a positive indication of our opportunities for future menu expansion to optimize the potential of the basic Pizza Hut unit.

Our franchisees continue to contribute entrepreneurial talents and operational techniques to the system. Our 20 largest franchisee groups operate over 60 per cent of the franchised units. Ability of their strong management teams to obtain financing on a local level has permitted their continued strong unit expansion in a very difficult economic period.



Financial
Review
1975

Five Year Summary of Operations

Fiscal years ended March 31

	1975	1974*	1973*	1972*	1971*
Net Sales					
Restaurant sales	\$139,200,368	\$102,223,795	\$72,693,815	\$52,478,363	\$35,585,911
Product sales to franchisees	28,315,208	16,809,829	7,126,975	4,289,473	2,715,140
Total net sales	167,515,576	119,033,624	79,820,790	56,767,836	38,301,051
Cost of Sales					
Restaurant	38,375,385	29,521,643	19,638,334	14,611,899	10,513,045
Product sales to franchisees	25,836,391	15,431,914	6,113,617	3,642,805	2,421,664
Total cost of sales	64,211,776	44,953,557	25,751,951	18,254,704	12,934,709
Gross profit	103,303,800	74,080,067	54,068,839	38,513,132	25,366,342
Initial fee income	747,000	843,500	589,000	335,500	316,534
Continuing fee income	3,709,467	2,279,508	1,341,036	830,166	739,335
Equity in net income or losses of unconsolidated foreign subsidiaries and minority-owned affiliates ..	(300,610)	(33,706)	151,436	113,824	
	107,459,657	77,169,369	56,150,311	39,792,622	26,422,211
Selling, general, and administrative expenses ..	86,916,192	62,742,658	46,688,500	34,235,354	23,721,957
	20,543,465	14,426,711	9,461,811	5,557,268	2,700,254
Other income	890,161	1,138,966	612,134	318,548	271,717
	21,433,626	15,565,677	10,073,945	5,875,816	2,971,971
Interest expense	2,014,091	1,275,066	819,513	588,248	452,779
Income before income taxes and extraordinary items ..	19,419,535	14,290,611	9,254,432	5,287,568	2,519,192
Provision for income taxes ..	9,395,670	7,055,086	4,440,985	2,490,957	1,252,808
Income before extraordinary items	10,023,865	7,235,525	4,813,447	2,796,611	1,266,384
Extraordinary items					213,000
Net income	\$ 10,023,865	\$ 7,235,525	\$ 4,813,447	\$ 2,796,611	\$ 1,479,384

*Restated

Management's Discussion and Analysis of the Summary of Operations

Sales

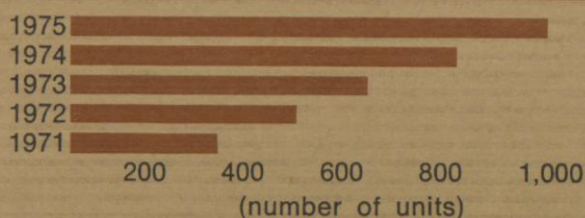
Total net sales —	1975	1974	1973
During the last five years, the Company has experienced annual total net sales growth in excess of 40%. Increases were 49% in fiscal 1974 and 41% in fiscal 1975. This growth was a result of both increased restaurant sales and product sales to franchisees. Both categories are discussed below:	\$167,515,576	\$119,033,624	\$79,820,790

Total Net Sales

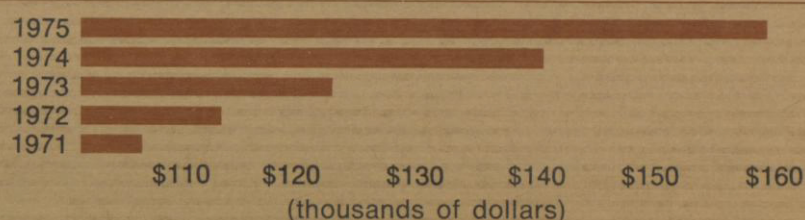


Restaurant sales —	1975	1974	1973
The growth in restaurant sales was 41% in 1974 and 36% in 1975. This growth can be viewed in two segments — additional Company-operated units and annual volume increases in existing units. The charts below reflect these increases. The Company increased units each fiscal year by new unit openings and acquisitions. Increased average unit volumes continue to contribute to sales growth with a 13% increase in both fiscal 1974 and fiscal 1975 in units open for the entire fiscal year. This increase was due in part to price increases averaging approximately 5% for the fiscal year ended March 31, 1974 and approximately 10% for the fiscal year ended March 31, 1975. Assuming that price increases were reflected in sales volumes on a dollar-for-dollar basis, the volume of products sold ("real sales") in Pizza Hut restaurants operated by the Company for the entire fiscal year increased over the previous year by approximately 8% for the fiscal year ended March 31, 1974 and by approximately 3% for the fiscal year ended March 31, 1975. The decline in real sales growth continued throughout the fiscal year ended March 31, 1975, and in the fourth quarter of such fiscal year real sales were 1.2% below real sales in the comparable period in the fiscal year ended March 31, 1974.	\$139,200,368	\$102,223,795	\$72,693,815

Company-operated Units



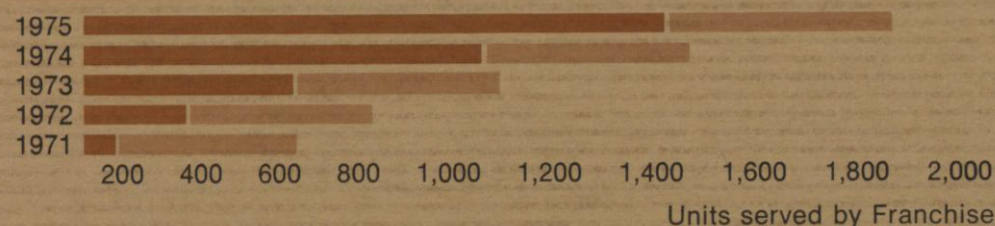
Average Annual Unit Volumes



Product sales to franchisees —	1975	1974	1973
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Franchise Services, Inc., a wholly-owned subsidiary, is engaged in the sale of equipment, certain food products, and supplies to Company and franchisee-operated units. The sales shown reflect the elimination of sales to Company-operated units. Product sales to franchisees increased 136% during 1974 and 68% during 1975. These increases were primarily due to the opening of additional distribution centers in Morrow, Georgia, and Orlando, Florida, during fiscal 1974 and in Arlington, Texas, and Indianapolis, Indiana, during fiscal 1975. The result of additional distribution centers increased the system units served on a weekly basis from approximately 53% at March 31, 1973, to approximately 71% at March 31, 1974, and to approximately 74% at March 31, 1975. Product sales to franchisees have grown from 9% of total net sales in fiscal 1973 to 14% in fiscal 1974 and to 17% in fiscal 1975.	\$ 28,315,208	\$ 16,809,829	\$ 7,126,975
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Total Number of Company and Franchised Pizza Hut Restaurants



Units served by Franchise Services, Inc.

Cost of Sales

Total cost of sales —	1975	1974	1973
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Cost of sales have increased from 32% of sales in fiscal 1973 to 38% of sales in fiscal 1974 and 1975. This is mainly due to the substantial increase in product sales to franchisees. The differences in cost of sales between the two sales categories are discussed below.	\$ 64,211,776	\$ 44,953,557	\$25,751,951
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Cost of sales — restaurant	1975	1974	1973
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The dollar increase in restaurant cost of sales was due to growth in sales. Restaurant operations averaged 29% cost of sales during fiscal 1974 and 28% cost of sales during fiscal 1975. This percentage decrease was due to price increases and to unit productivity.	\$ 38,375,385	\$ 29,521,643	\$19,638,334
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Cost of sales — product sales to franchisees

1975

1974

1973

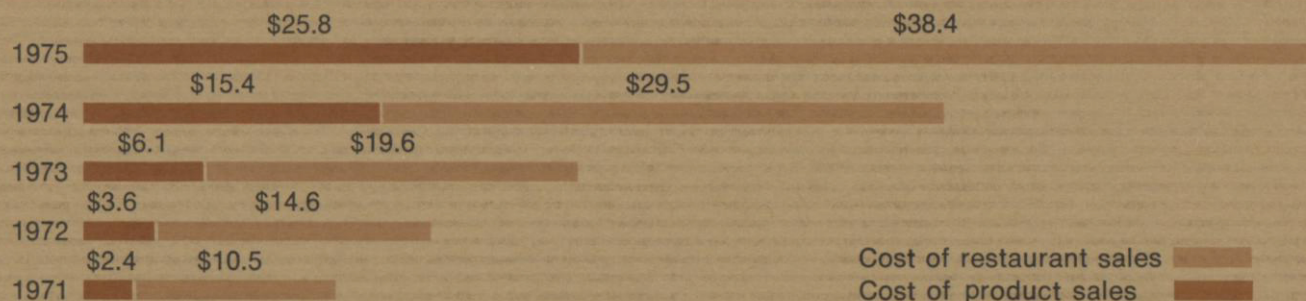
The dollar increase in this category relates to sales growth. Although the cost of sales as a percentage to product sales to franchisees remained relatively constant at 92% and 91% for fiscal 1974 and fiscal 1975, its percentage of the total cost of sales increased as illustrated below. This percentage increase is the primary reason for the total cost of sales increase as a percentage of total net sales previously noted.

\$ 25,836,391

\$ 15,431,914

\$ 6,113,617

Annual Cost of Sales Dollars (in millions)



Other income

Initial franchise fees —

1975

1974

1973

The Company receives an initial franchise fee upon the opening of each new franchised Pizza Hut restaurant. The amounts of the fees have varied over the years, but generally range between \$4,000 and \$6,000 for each unit opened. The increase in fees for fiscal 1974 as compared to the decrease for fiscal 1975 is directly related to the number of stores opened each year.

\$ 747,000

\$ 843,500

\$ 589,000

Continuing franchise fees —

1975

1974

1973

Each franchised Pizza Hut restaurant pays a monthly fee to the Company which is usually computed as a percentage of sales. The 70% increase during fiscal 1974 and the 63% increase during fiscal 1975 are directly related to the number of new franchised unit openings and increased average annual unit volumes.

\$ 3,709,467

\$ 2,279,508

\$ 1,341,036

Equity in foreign and minority-owned affiliates —

1975

1974

1973

The annual earnings of all foreign subsidiaries and minority-owned affiliates are recorded under this heading. The increased losses during fiscal 1974 and fiscal 1975 were for the most part losses incurred in Germany and Canada. Subsequent to year-end, Company operations were discontinued in Germany. Units in Canada

\$ (300,610)

\$ (33,706)

\$ 151,436

have shown improvement and the country merits continued development. Australia and Mexico continue to contribute increased profits.

Other income —	1975	1974	1973
This item consists primarily of interest income on funds held pending use in the development of new Company-operated Pizza Hut restaurants. The fluctuation in such income is primarily attributable to the timing of the Company's use of such funds for such purposes and the fluctuation in short-term interest rates.	\$ 890,161	\$ 1,138,966	\$ 612,134

Selling, General, and Administrative Expenses	1975	1974	1973
Although as a percentage of sales, these expenses have decreased from 58% during fiscal 1973 to 53% during fiscal 1974 and to 52% during fiscal 1975, the total dollars have increased for the most part at a rate which is consistent with the growth of the Company.	\$ 86,916,192	\$ 62,742,658	\$46,688,500

The Company has been increasing the dollars spent on advertising. The total expenditure for fiscal 1974 was approximately \$3,500,000 while fiscal 1975 was approximately \$5,200,000.

Interest Expense	1975	1974	1973
The Company's increased ownership of units required additional borrowing and has necessitated increased interest expense for fiscal 1974 and fiscal 1975.	\$ 2,014,091	\$ 1,275,066	\$ 819,513

Income Taxes	1975	1974	1973
The effective tax rate for fiscal 1974 and fiscal 1975 was 49.4% and 48.4%, respectively. This decrease in the tax rate was due primarily to an increase in investment tax credits in fiscal 1975.	\$ 9,395,670	\$ 7,055,086	\$ 4,440,985

For additional information on income taxes, see the notes to the consolidated financial statements.

Stock Market Information

PIZ Common Stock is traded on the New York Exchange. The stock price range on the New York Exchange for the past two years, by quarters, was:

Quarter Ended	1975		1974		
	High	Low	High	Low	
June 30	24 ¹ / ₄	17 ³ / ₄	21 ³ / ₄	14 ¹ / ₄	The Company has not paid dividends since the initial public offering of its Common Stock in 1968, and presently intends to continue to retain all earnings for use in its business.
September 30	21 ³ / ₄	12	29 ¹ / ₄	15 ³ / ₈	
December 31	16 ³ / ₄	12 ¹ / ₂	33 ¹ / ₂	14 ³ / ₄	
March 31	25 ¹ / ₄	12 ³ / ₄	23 ⁷ / ₈	15 ¹ / ₄	

Statements of Consolidated Income

Pizza Hut, Inc. and Subsidiaries

	Years ended March 31,	
	1975	1974 Restated — Note B
Net sales		
Restaurant sales	\$139,200,368	\$102,223,795
Product sales to franchisees	28,315,208	16,809,829
TOTAL NET SALES	167,515,576	119,033,624
Cost of Sales		
Restaurant	38,375,385	29,521,643
Product sales to franchisees	25,836,391	15,431,914
TOTAL COST OF SALES	64,211,776	44,953,557
GROSS PROFIT	103,303,800	74,080,067
Initial franchise fees	747,000	843,500
Continuing franchise fees	3,709,467	2,279,508
Equity in net income or losses of unconsolidated foreign subsidiaries and minority-owned affiliates	(300,610)	(33,706)
	107,459,657	77,169,369
Selling, general, and administrative expenses	86,916,192	62,742,658
	20,543,465	14,426,711
Other income (including interest: 1975 — \$631,425; 1974 — \$837,979)	890,161	1,138,966
	21,433,626	15,565,677
Interest expense	2,014,091	1,275,066
INCOME BEFORE INCOME TAXES	19,419,535	14,290,611
Provision for income taxes	9,395,670	7,055,086
NET INCOME	\$ 10,023,865	\$ 7,235,525
Net income per share:		
Primary — assuming exercise of options and warrants		
1975 — 4,521,450		
1974 — 4,517,460	\$2.22	\$1.60
Fully diluted — assuming, in addition, conversion of convertible notes		
1975 — 4,615,787		
1974 — 4,554,521	\$2.18	\$1.59

See notes to consolidated financial statements.

Consolidated Balance Sheets

Pizza Hut, Inc. and Subsidiaries

ASSETS

	March 31,	
	1975	1974 Restated — Note B
CURRENT ASSETS		
Cash	\$ 5,488,091	\$ 5,622,333
Certificates of deposit		5,800,000
Properties under construction for sale and leaseback	7,532,695	1,175,099
Receivables:		
Notes	170,905	99,446
Trade accounts	3,059,217	2,491,301
Other accounts	480,961	222,582
Allowance for doubtful notes and accounts	(115,000)	(115,000)
	<u>3,596,083</u>	<u>2,698,329</u>
Inventories	8,500,415	5,287,675
Prepaid expenses	524,366	442,978
TOTAL CURRENT ASSETS	25,641,650	21,026,414
INVESTMENTS AND OTHER ASSETS		
Investments in and advances to unconsolidated affiliates:		
Foreign subsidiaries	3,504,783	3,189,289
Other affiliates	1,438,177	1,047,254
	<u>4,942,960</u>	<u>4,236,543</u>
Cost in excess of net assets of businesses acquired, less amortization	3,588,472	3,623,647
Patents, service marks, and franchises	1,663,217	1,546,647
Notes receivable	303,464	454,058
Other accounts	2,234,956	1,866,924
	<u>12,733,069</u>	<u>11,727,819</u>
PROPERTY, PLANT, AND EQUIPMENT — Note C		
Land	7,621,383	6,361,604
Buildings and improvements	9,367,762	5,516,765
Leasehold improvements	11,146,080	8,482,459
Operating equipment	27,499,909	17,848,411
	<u>55,635,134</u>	<u>38,209,239</u>
Allowances for depreciation and amortization (deduction)	(10,584,576)	(7,286,510)
	<u>45,050,558</u>	<u>30,922,729</u>
DEFERRED CHARGES		
Organization expense	235,996	276,535
Deferred income taxes	1,358,384	1,061,269
Other	169,517	205,513
	<u>1,763,897</u>	<u>1,543,317</u>
	<u>\$85,189,174</u>	<u>\$65,220,279</u>

See notes to consolidated financial statements.

LIABILITIES AND STOCKHOLDERS' EQUITY

	March 31,	
	1975	1974 Restated — Note B
CURRENT LIABILITIES		
Trade accounts payable	\$ 6,164,078	\$ 4,667,070
Taxes, other than income	1,880,257	1,364,897
Federal and state income taxes	3,418,110	3,950,094
Other accrued expenses	1,769,340	1,306,873
Current portion of long-term debt	1,380,367	1,193,602
TOTAL CURRENT LIABILITIES	14,612,152	12,482,536
 LONG-TERM DEBT — less portion classified as current liability — Note C	 22,488,416	 15,653,559
 DEFERRED INITIAL FRANCHISE FEE INCOME	 766,200	 596,000
 ESTIMATED FUTURE LEASE COSTS — Note D	 1,200,000	 800,000
 STOCKHOLDERS' EQUITY — Notes C and F		
Preferred Stock — \$0.01 par value		
Authorized 1,000,000 shares; none issued	—	—
Common Stock — \$0.01 par value		
Authorized 10,000,000 shares issued and outstanding 4,479,330 shares in 1975 and 4,457,084 shares in 1974	44,794	44,571
Other capital	362,547	362,547
Additional paid-in capital	18,003,354	17,593,220
Retained earnings	27,713,275	17,689,410
Treasury Stock (7,282 shares) at cost	(1,564)	(1,564)
	46,122,406	35,688,184
 LEASES AND CONTINGENT LIABILITIES — Notes G and I		
	\$85,189,174	\$65,220,279

Statement of Consolidated Stockholders' Equity

Pizza Hut, Inc. and Subsidiaries

Years ended March 31, 1975 and 1974

	Common Stock		Other Capital	Additional Paid-in Capital	Retained Earnings	Treasury Stock
	Shares	Amount				
Balance at April 1, 1973:						
As previously reported	3,287,354	\$32,873	\$362,547	\$13,884,692	\$ 8,285,835	\$ —
Adjustment for acquisition of pooled companies —						
Note B	1,147,245	11,473		3,472,755	2,168,050	(1,130)
As restated	4,434,599	44,346	362,547	17,357,447	10,453,885	(1,130)
Capital transactions of pooled companies before acquisition				22,000		
Amounts received to exercise and extend employee stock options . . .	13,662	137		138,861		
Conversion of 8% Convertible Note	8,823	88		74,912		
Acquisition of 1,900 shares of treasury stock						(434)
Net income					7,235,525	
BALANCE AT MARCH 31, 1974	4,457,084	44,571	362,547	17,593,220	17,689,410	(1,564)
Pooled company's fractional shares not converted	(6,247)	(62)		62		
Amounts received to exercise and extend employee stock options . . .	28,493	285		410,072		
Net income					10,023,865	
BALANCE AT MARCH 31, 1975	4,479,330	\$44,794	\$362,547	\$18,003,354	\$27,713,275	(\$1,564)

See notes to consolidated financial statements.

Statements of Changes in Consolidated Financial Position

Pizza Hut, Inc. and Subsidiaries

	Years ended March 31,	
	1975	1974
SOURCE OF FUNDS		
Net income	\$10,023,865	\$ 7,235,525
Charges (credits) to income not affecting funds:		
Depreciation and amortization	4,180,454	2,925,031
Decrease (increase) in deferred income taxes	(56,115)	(422,517)
Increase (decrease) in deferred initial franchise fees	170,200	(93,000)
Provision for future lease costs	400,000	800,000
Equity in net loss of unconsolidated foreign subsidiaries and minority-owned affiliates	300,610	33,706
TOTAL FROM OPERATIONS	15,019,014	10,478,745
Proceeds from long-term debt	19,266,923	10,552,269
Disposals of property, plant, and equipment including sale and leaseback transactions	24,984,630	7,524,794
Other items	560,951	235,998
	59,831,518	28,791,806
APPLICATION OF FUNDS		
Assets of purchased companies:		
Property, plant, and equipment	202,732	1,161,309
Franchise rights and other assets	150,166	617,415
Cost in excess of net assets acquired	41,664	1,207,129
Long-term debt assumed	(17,917)	(342,177)
	376,645	2,643,676
Additions to property, plant, and equipment	42,818,517	17,939,654
Reductions of long-term debt	12,449,983	3,419,802
Investments in and advances to unconsolidated foreign subsidiaries and minority-owned affiliates	1,016,980	2,026,276
Other items	683,773	286,354
	57,345,898	26,315,762
INCREASE IN WORKING CAPITAL	\$ 2,485,620	\$ 2,476,044
INCREASE (DECREASE) IN WORKING CAPITAL BY COMPONENT		
Cash	(\$ 134,242)	\$ 1,623,022
Certificates of Deposit	(5,800,000)	100,000
Properties under construction for sale and leaseback	6,357,596	1,175,099
Trade and other receivables	897,754	107,560
Inventories	3,212,740	2,265,888
Prepaid expenses	81,388	22,945
Notes payable and current portion of long-term debt	(186,765)	943,206
Trade accounts payable and accrued expenses	(2,474,835)	(2,624,158)
Income taxes	531,984	(1,137,518)
INCREASE IN WORKING CAPITAL	\$ 2,485,620	\$ 2,476,044

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

March 31, 1975 and 1974

Pizza Hut, Inc. and Subsidiaries

NOTE A — ACCOUNTING POLICIES**PRINCIPLES OF CONSOLIDATION**

The consolidated financial statements include the accounts of all domestic subsidiaries after elimination of significant intercompany accounts and transactions.

FOREIGN SUBSIDIARIES AND OTHER AFFILIATES

Investments in wholly-owned subsidiaries in Australia, Canada, Germany, Mexico, Japan, and England and investments in certain minority-owned domestic affiliates are carried at cost plus equity in net income of the foreign subsidiaries and domestic affiliates. The assets, liabilities, revenues, and net income (losses) of these foreign subsidiaries were not significant.

INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out method) or market.

PROPERTY, PLANT, AND EQUIPMENT AND DEPRECIATION POLICIES

Property, plant, and equipment is carried on the basis of cost and depreciation is determined principally by the straight-line method over the following ranges of useful lives:

Buildings and improvements	20 to 30 years
Operating equipment	3 to 10 years
Leasehold improvements	Term of lease

SALE AND LEASEBACK TRANSACTIONS

Gains or losses (which were not material) from the sale of properties under sale and leaseback transactions are deferred and amortized over the respective lease terms. The leases involved in these transactions are considered to be financing leases and are included in the information in Note G. Properties under construction at the end of the year which have been committed for sale and leaseback during the following year have been classified as current assets in the accompanying balance sheet.

AMORTIZATION POLICIES

Amortization of intangibles and deferred charges is determined principally by the straight-line method. The cost in excess of net assets of businesses acquired prior to October 31, 1970 is not amortized since, in the opinion of management, there has been no diminution in value. Such amounts acquired after October 31, 1970 (\$3,483,129 including amounts attributable to unconsolidated subsidiaries and affiliates) and the cost of substantially all liquor licenses are amortized over a forty-year life. Franchise rights, deferred debt expense, and organization costs are amortized over fifteen-year lives. Deferred site development costs are amortized over five-year lives.

INITIAL FRANCHISE FEE INCOME

Upon the sale of a franchise, the Company records the amount received or receivable as an asset and the fee as deferred franchise fee income. The initial franchise fee is recorded as income when the retail unit has been opened by the franchisee.

INVESTMENT TAX CREDITS

Investment tax credits are accounted for using the flow-through method.

RESEARCH AND DEVELOPMENT

The Company charges all research and development expenses (which are not material) to expense at the date incurred.

NET INCOME PER SHARE

Employee stock options, warrants attributable to the 8¾% Senior Notes, and options under a director's deferred compensation plan are considered to be Common Stock equivalents in the computation of primary net income per share using the treasury stock method applied at the average market price during the period.

In the computation of fully-diluted net income per share, the Common Stock equivalents plus the shares issuable in the assumed conversion of convertible notes are considered and interest expense (net of applicable income taxes) attributable to the convertible notes is added to net income. The treasury stock method is applied to Common Stock equivalents at the year end market price if higher than the average market price.

NOTE B — ACQUISITIONS

In September, 1974, the Company acquired its largest franchisee, Pizza Corporation of America (PCA) in exchange for 1,144,161 shares of Common Stock in a transaction accounted for as a pooling of interests. PCA operated 225 Pizza Hut restaurant units at the date of acquisition. The 1975 consolidated statement of income includes PCA net sales of \$13,969,169 and net income of \$1,508,658 (after elimination of intercompany transactions) for the period from April 1, 1974, to the date of acquisition. The 1974 financial statements have been restated to include the operations of PCA. After elimination of intercompany transactions, this restatement increased net sales by \$20,624,187 and net income by \$2,073,800, and increased primary and fully diluted net income per share by \$.07. Also during 1975 the Company acquired one unit in a purchase transaction at a cost of \$17,758 and its operations (which are not material) are included in the consolidated statement of income from the date of acquisition.

The Company acquired 28 Pizza Hut restaurants in 1974 in exchange for 112,440 shares of the Company's Com-

mon Stock in transactions accounted for as poolings of interests. The Company also acquired 18 restaurants and a fifty per cent interest in a corporation owning ten restaurants in 1974 in transactions accounted for as purchases at a cost of \$1,743,140 and this cost exceeded the value of net assets acquired by \$1,232,465. The operations of purchased units have been included in the accompanying financial statements from the respective dates of their acquisition.

NOTE C — LONG-TERM DEBT

	1975	1974
10 $\frac{3}{8}$ % Promissory Notes payable in semi-annual installments of \$725,000 from October, 1979 to April, 1990	\$12,000,000	\$ —
9 $\frac{1}{4}$ % Promissory Notes payable in semi-annual installments of \$300,000 from July, 1978 to January, 1988	—	6,000,000
8 $\frac{3}{4}$ % Senior Notes payable in annual installments of \$250,000 from March, 1978 to March, 1987	2,385,340	2,360,875
Mortgage and Equipment Notes payable in monthly installments of \$42,588 including interest at rates from 3% to 11% maturing at various dates to 1996	2,150,670	2,043,077
Notes payable to banks in quarterly installments of \$178,570 plus interest at $\frac{3}{4}$ % over prime rate to October, 1981	4,821,430	—
Notes payable to banks in quarterly installments of \$100,000 plus interest at 1 $\frac{1}{4}$ % over prime rate to December, 1976	—	1,100,000
Notes payable to banks in quarterly installments of \$57,500 from April, 1975 to January, 1977 and \$115,000 from April, 1977 to January, 1981 plus interest at $\frac{3}{4}$ % over prime rate	—	2,300,000
Convertible Notes due in 1976 and 1978 with interest at rates from 7% to 8%	1,096,000	1,096,000
Other Unsecured Notes payable in monthly installments of \$33,344 plus interest at rates of 6 $\frac{1}{4}$ % to 9 $\frac{1}{2}$ % maturing at various dates through 1979	1,415,343	1,947,209
	<u>23,868,783</u>	<u>16,847,161</u>

Less amounts due within one year	1,380,367	1,193,602
	<u>\$22,488,416</u>	<u>\$15,653,559</u>

Installments on the 10 $\frac{3}{8}$ % Promissory Notes include amounts payable on an additional \$4,000,000 note which the Company is committed to issue by October 1, 1975.

The Senior Notes were issued with detachable Warrants to purchase 87,500 shares of Common Stock at \$9.25 a share. The \$2,500,000 face amount of these notes has been reduced by the discount attributable to the Warrants resulting in an effective interest rate of 9 $\frac{1}{3}$ %.

Property, plant, and equipment with a carrying value of approximately \$5,530,000 has been pledged as collateral to the Mortgage and Equipment Notes.

The Convertible Notes are convertible into shares of the Company's Common Stock at the following rates: \$150,000 at \$8.50 a share; \$350,000 at \$25.00 a share; \$596,000 at \$31.63 a share.

The Company has agreed, under certain long-term agreements, to maintain working capital of \$5,000,000 and to maintain a current ratio of at least 1.25 to 1. The agreements also contain certain restrictions which, among other things, prohibit the payment of dividends or the purchase of the Company's Common Stock unless certain debt service and earnings tests are met. At April 1, 1975, under the most restrictive of these requirements retained earnings of approximately \$3,500,000 were unrestricted for such purposes.

Maturities of long-term debt for the next five years are as follows: 1976 — \$1,380,367; 1977 — \$1,784,215; 1978 — \$1,374,380; 1979 — \$2,259,612; 1980 — \$1,140,301.

NOTE D — ESTIMATED FUTURE LEASE COSTS

Certain leased properties have been closed and the Company has provided for the estimated present value of these future net lease costs by charging a total of \$1,200,000 to selling, general and administrative expenses in the 1975 and 1974 Consolidated Statements of Income.

NOTE E — SALE AND LEASEBACK TRANSACTIONS

During the two years ended March 31, 1975, the Company constructed and sold the following properties to outside parties and leased the properties back for periods of 20 to 23 years.

	Properties Sold	Selling Price
1975	118	\$17,846,000
1974	49	\$ 6,438,000

NOTE F — STOCK OPTIONS

Under the terms of the employee stock option plans, the Company may grant options to officers and employees to purchase shares of its Common Stock at a price not less than the fair market value of the stock at date of grant. Activity under these plans is summarized as follows:

	Number of Shares	Option Price	
		Per Share	Total
Outstanding April 1, 1973	106,276	\$ 9.38 to \$30.45	\$1,865,638
Granted	130,307	14.55 to 18.18	2,142,958
Cancelled	(32,754)	9.38 to 30.45	(732,280)
Exercised	(13,662)	9.38 to 20.56	(137,683)
Outstanding March 31, 1974	190,167	9.38 to 30.00	3,138,633
Granted	27,220	13.00 to 18.38	429,989
Cancelled	(18,515)	9.38 to 30.00	(322,604)
Exercised	(28,493)	9.38 to 22.67	(410,730)
Outstanding March 31, 1975 (of which 54,365 were exercisable)	170,379	\$ 9.62 to \$28.48	\$2,835,288
Became exercisable in 1974	33,114	\$ 9.38 to \$30.00	\$ 518,216
Became exercisable in 1975	51,807	\$ 9.62 to \$28.48	\$ 868,431

At March 31, 1975, Common Stock was reserved as follows:

	Shares
Employee stock option plan	334,859
Warrants to purchase Common Stock at \$9.25 a share	87,500
Convertible notes	50,493
Other stock options	9,854
	<u>482,706</u>

NOTE G — LEASES

Total rent expense for all leases is summarized as follows:

	1975	1974
Financing leases:		
Minimum rentals	\$ 8,524,187	\$7,232,325
Contingent rentals	262,050	118,294
Other leases:		
Minimum rentals	2,949,755	2,176,459
Contingent rentals	705,751	412,307
Sublease rental income	(478,981)	(291,240)
	<u>\$11,962,762</u>	<u>\$9,648,145</u>

Contingent rentals represent mileage rates on transportation equipment and additional rentals on restaurant buildings based upon a percentage of sales.

The future minimum rental commitments as of March

31, 1975, for all noncancelable leases are as follows:

	Total	Financing Leases		Other Leases	
		Restaurants	Equipment	Restaurants	Buildings and Equipment
1976	\$ 12,844,631	\$ 10,153,269	\$287,264	\$1,068,489	\$1,335,609
1977	12,108,024	10,217,369	155,678	1,009,324	725,653
1978	11,643,174	10,215,211	132,957	888,402	406,604
1979	11,319,599	10,198,982	126,353	723,997	270,267
1980	11,008,865	10,173,223	126,353	592,633	116,656
1981-85	50,740,338	48,502,271	73,706	2,164,361	
1986-90	37,803,637	36,412,152		1,391,485	
1991-96	20,397,083	19,870,462		526,621	
Thereafter	1,376,206	1,178,406		197,800	
	<u>\$169,241,557</u>	<u>\$156,921,345</u>	<u>\$902,311</u>	<u>\$8,563,112</u>	<u>\$2,854,789</u>

The above commitments have not been reduced by anticipated rental income from existing noncancelable subleases in the approximate amount of \$1,540,000. These subleases relate primarily to restaurants and generally cover a shorter term than the respective prime lease. The restaurant leases generally include renewal provisions of from 5 to 20 years at the original rental rates.

The estimated present values of minimum lease commitments under financing leases (as defined by the Securities and Exchange Commission) are summarized as follows:

	1975	1974
Restaurants	\$69,487,825	\$53,567,877
Less: Sublease rentals	540,317	550,864
	<u>68,947,508</u>	<u>53,017,013</u>
Other buildings and equipment	799,303	2,152,937
	<u>\$69,746,811</u>	<u>\$55,169,950</u>

Interest rates implicit in the financing leases range from 5.9% to 17.1% for restaurants and 8.5% to 15.6% for other buildings and equipment (weighted average 9.8% and 10.0%, respectively).

If all financing leases had been capitalized, it is estimated that net income for the years 1975 and 1974 would have been reduced by \$886,000 and \$733,000, respectively. This computation assumes that the estimated present values (including present values attributable to land) were amortized on a straight-line basis over the terms of the leases and that interest expense was accrued on the outstanding lease obligations at the rates shown above. The amounts included for amortization of leased property (including land) and interest expense were \$4,188,000 and \$6,191,000, respec-

tively in 1975 and \$3,456,000 and \$4,954,000, respectively in 1974.

NOTE H — INCOME TAXES

Federal and state income taxes consist of the following:

	1975		1974	
	Current	Deferred	Current	Deferred
Federal	\$8,213,285	(\$51,615)	\$6,578,916	(\$392,217)
State	1,238,500	(4,500)	898,687	(30,300)
	<u>\$9,451,785</u>	<u>(\$56,115)</u>	<u>\$7,477,603</u>	<u>(\$422,517)</u>

Deferred income tax expense results principally from the provision for future lease costs which is not currently deductible for tax purposes.

The reasons for the difference between the total tax expense and the amount computed by applying the statutory Federal income tax rate of 48% to income before income taxes are as follows:

	1975	1974
48% of pre-tax income	\$9,321,377	\$6,859,493
Add state taxes net of Federal tax benefit	641,680	451,561
	<u>9,963,057</u>	<u>7,311,054</u>
Deduct:		
Investment tax credit	(880,066)	(488,000)

Other	312,679	232,032
	<u>\$9,395,670</u>	<u>\$7,055,086</u>

NOTE I — CONTINGENT LIABILITIES

The Company has guaranteed obligations of unconsolidated affiliated companies and others amounting to approximately \$3,200,000.

At March 31, 1975, as a result of various transactions, the Company was guarantor of lease commitments of certain franchisees. The annual rentals and the estimated present value of these guaranteed leases is summarized as follows:

Transaction	Annual Rental	Present Value
Guaranteed for a fee	\$302,440	\$1,900,442
Guaranteed for minority interest	501,955	3,901,995
Formerly owned units sold to franchisees ...	143,719	860,378
	<u>\$948,114</u>	<u>\$6,662,815</u>

The Company is a party to lawsuits arising out of the normal course of its business. The disposition of such litigations will not, in the opinion of management and legal counsel, result in a material adverse effect on the Company's financial position.

NOTE J — SUBSEQUENT EVENTS

On April 25, 1975, the Company announced its intention to sell \$25,000,000 of convertible subordinated debentures.

Accountants' Report

ERNST & ERNST

1050 VICKERS KSB&T BUILDING
WICHITA, KANSAS 67202

Stockholders and Board of Directors
Pizza Hut, Inc.
Wichita, Kansas

We have examined the consolidated balance sheets of Pizza Hut, Inc. and its subsidiaries as of March 31, 1975 and March 31, 1974, and the related consolidated statements of income, stockholders' equity, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the consolidated financial statements of Pizza Corporation of America, a consolidated subsidiary, for the year ended March 31, 1974, which statements reflect total assets and net sales constituting 23% and 20% respectively, of the consolidated totals. These statements were examined by other auditors whose report thereon has been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included for Pizza Corporation of America and subsidiaries, is based solely on the reports of the other auditors.

In our opinion, based upon our examinations and the report of other auditors, the financial statements referred to above present fairly the consolidated financial position of Pizza Hut, Inc. and subsidiaries at March 31, 1975 and March 31, 1974, and the consolidated results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Wichita, Kansas
May 19, 1975

Ernst & Ernst

Officers and Directors

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We are proud to be a member
of this organization, and fully
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We believe Pizza Hut
shareholders desire to receive
as much information about
their company as possible and
we want to communicate with
all our shareholders, including
those whose stock is held in
brokerage accounts rather
than in their name.

If you believe in the necessity
of information and want to be
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Frank L. Carney, President
Chairman of the Board
& Chief Executive Officer

